

STATE OF CALIFORNIA
ELECTRICITY OVERSIGHT BOARD



Gray Davis, Governor

May 7, 2001

VIA E-MAIL FOR ELECTRONIC FILING

Hon. David P. Boergers, Secretary
Federal Energy Regulatory Commission
888 First Street, NE
Washington, D.C. 20426

**Re: Investigation of Wholesale Rates of Public Utility Sellers of Energy and
Ancillary Services in the Western Systems Coordinating Council
Docket No. EL01-68-000**

Dear Mr. Boergers:

Pursuant to Order No. 619, the Electricity Oversight Board hereby submits an electronic filing of its Motion To Intervene and Comments in the above-referenced dockets.

Thank you for your assistance.

Sincerely,

/s/

Grant A. Rosenblum
Staff Counsel
Electricity Oversight Board

cc: Official Service List of EL00-95-012

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Wholesale Rates
of Public Utility Sellers of Energy
and Ancillary Services in the
Western Systems Coordinating
Council

Docket No. EL01-68-000

San Diego Gas & Electric Company,

Docket No. EL00-95-012

Investigation of Practices of the
California Independent System
Operator and the California Power
Exchange

Docket No. EL01-98-000

California Independent System Operator
Corporation

Docket No. RT01-85-000

**MOTION TO INTERVENE AND COMMENTS
BY THE CALIFORNIA ELECTRICITY OVERSIGHT BOARD**

Pursuant to the Commission's Rules of Practice and Procedure, 18 C.F.R. §§
385.214(a)(3) and (b), and Ordering Paragraph (K) of the Commission's Order
Establishing Prospective Mitigation and Monitoring Plan for the California Wholesale
Electric Markets and Establishing an Investigation of Public Utility Rates in Wholesale
Western Energy Markets, dated April 26, 2001¹ ("April 26 Mitigation Order"), the
California Electricity Oversight Board ("Board") hereby moves to intervene and
comment² in Docket No. EL01-68-000.

¹ *San Diego Gas & Electric Company, et al.*, 95 FERC ¶ 61,115 (April 26, 2001).

I. CORRESPONDENCE AND COMMUNICATIONS

The principal office of the Board is located at 770 L Street, Suite 1250, Sacramento, California, 95814. All pleadings, orders, correspondence and communications regarding this motion should be directed to the following persons:

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II. MOTION TO INTERVENE

The Board hereby moves to intervene in Docket No. EL01-68-000 to obtain party status to represent itself and the responsibilities assigned to it by the State of California. The Board was created as a component of California's comprehensive restructuring legislation. The Board's statutory responsibilities include oversight of the California Independent System Operator Corporation ("CAISO"), the energy and ancillary services markets administered by the ISO, and the reliability of the California electricity grid. The Board's statutory responsibilities also include oversight of the California Power Exchange Corporation ("PX") and the energy markets formerly operated by the PX.

In the April 26 Mitigation Order, the Commission, among other things, instituted an investigation into the rates, terms, and conditions of public utility sales for resale of electric energy in interstate commerce in the Western System Coordinating Counsel

² Given the compacted time period extended by the Commission to formulate comments in this proceeding, the Board hereby reserves its right to supplement these comments and submit additional evidence.

(“WSCC”) other than sales through the CAISO markets.³ The Commission commenced this investigation, in part, in recognition that the western United States forms an integrated electricity market.⁴ The Commission further acknowledged that, because of interstate market integration, any effective response to concerns regarding anti-competitive manipulation of the California electric wholesale markets requires examination of the entire western region.⁵

The regional investigation assigned to Docket No. EL01-68-000 will address matters having a significant impact on the proper and efficient operation of the CAISO’s real-time energy and ancillary services markets. These are core functions delegated to the CAISO in order to fulfill its statutory obligation of maintaining the reliability of California’s electricity grid. The Commission’s decision in this proceeding, therefore, will directly affect the statutory responsibilities assigned to the Board such that the Board’s participation in this proceeding is in the public interest of the citizens of the State of California. No other party can adequately represent the Board’s interests. (18 C.F.R. §§ 385.214(b)(2)(ii) and 385.214(b)(2)(iii).) Thus, the Board respectfully requests that the Commission grant this motion to intervene.

III. COMMENTS

Section IV of the April 26 Mitigation Order declares that the Commission, pursuant to section 206 of the Federal Power Act, is instituting a “West-Wide Investigation.” The West-Wide Investigation intends to encompass:

³ *Id.* at mimeo. pp. 3, 26, and 28.

⁴ *Id.* at mimeo. p. 11.

⁵ *Ibid.*

the rates, terms and conditions of public utility sales for resale of electric energy in interstate commerce in the WSCC other than sales through the California ISO markets, to the extent that such sales for resale involve: (1) electric energy sold in real-time spot markets (i.e., up to 24 hours in advance); and (2) take place during conditions when contingency reserves (as defined by the WSCC) for any control area fall below 7 percent.⁶

The Commission further proposes that any sales made in real-time spot markets in the WSCC outside of California will be subject to price mitigation. Such price mitigation will be limited to system conditions when contingency reserves fall below 7% for any control area. In addition, the Commission proposes that all non-hydroelectric generators and marketers with the WSCC will be required to offer for sale in any real-time market all energy contractually and operationally available.⁷

A. The Commission Has Failed To Satisfy Its Statutory Obligation to Ensure Just and Reasonable Prices Throughout the Western States.

With the grant of jurisdiction to regulate wholesale electric markets comes responsibility. Section 205 of the Federal Power Act unequivocally defines the Commission's responsibility - *ensure that all wholesale electric energy rates and charges are just and reasonable*. Unjust and unreasonable rates are per se unlawful. (16 U.S.C. § 824d(a).)

The Commission continues to abdicate its statutory responsibility to protect California from unjust and unreasonable rates. By confining price mitigation to California ISO real-time transactions occurring during periods of reserve deficiency, the April 26 Mitigation Order rests on the untenable premise that the California electric

⁶ *Id.* at mimeo. pp. 26-27.

⁷ *Id.* at mimeo. p. 27.

wholesale market is functionally competitive during all other circumstances so as to guarantee that bilateral and other out-of-market transactions are just and reasonable. Thus, the Commission again ignores the record compiled in this and related proceedings that establishes that the exercise of market power in California is not limited to real-time auction transactions or conditions of reserve emergencies, but instead occurs in all hours and under all conditions.⁸ Indeed, as Commission Massey correctly stated, “[t]he record is devoid of any evidence that the problem is limited to hours when an operating reserve margin alert at stages 1, 2 or 3 is in effect.”⁹

The Commission perpetuates its error in the West-Wide Investigation. The period and scope subject to mitigation are unduly narrow. This is especially true in the context of the WSCC outside of California. No true day-ahead real-time market exists. Most short-term sales are conducted bilaterally through inter-utility transactions.¹⁰ Consequently, the 24-hour advance sales limitation is arbitrary and subject to manipulation to avoid monitoring and mitigation (i.e., power sold 25 hours in advance).¹¹

As noted, overwhelming evidence exists for California that market power is being wielded around the clock and well in advance of delivery in all seasons. Even if such evidence is not sufficient to affirmatively establish specific instances of market

⁸ See, e.g., Comments of the California Independent System Operator on Staff’s Recommendation on Prospective Market Monitoring and Mitigation, Attachment C: Empirical Evidence of Strategic Bidding in California ISO Real Time Market (March 21, 2001); Wolak and Nordhaus, Comments on Staff Recommendation on Prospective Market Monitoring and Mitigation for the California Wholesale Electricity Market (March 22, 2001); Hildebrandt, Further Analyses of the Exercise of and Cost Impacts of Market Power in California’s Wholesale Energy Market (March 2001).

⁹ April 26 Mitigation Order (Massey Dissent), at mimeo. p. 3.

¹⁰ Market power impacts forward markets. In fact, the Commission’s underscheduling penalty may enhance a suppliers ability to exercise of market power in short-term forward bilateral transactions.

¹¹ Commissioner Massey noted that “many of the transactions that are driving the high prices in Washington, Oregon and other western states are for terms well exceeding 24 hours.” (*Id.* mimeo at p. 4.)

power outside of California for section 206 purposes, the record compiled by the Commission compels a presumption that market power is nevertheless being exercised in a pervasive manner throughout the WSCC. Under such circumstances, the Commission's statutory mandate clearly precludes a finding, even on an interlocutory basis, that the western electric wholesale market can produce just and reasonable prices. It is, therefore, incumbent on the Commission to institute measures for California and the entire west, during the pendency of the West-Wide Investigation, that will ensure just and reasonable prices during all hours and all conditions. Absent comprehensive coverage of an effective mitigation plan, the Commission must suspend market based rate authority for all generators and marketers operating in the WSCC, including California, until such time as the Commission can find that western electric wholesale markets are sufficiently competitive to produce just and reasonable rates.

B. The West-Wide Investigation Fails To Address Issues Of Market Manipulation, Including "Megawatt Laundering."

The Commission notes in the April 26 Mitigation Order that "[s]everal commenters ... raise concerns about so-called 'megawatt laundering' where the supplier schedules supply out-of-state and then reimports that power to avoid a mitigated price." The Commission's response to the megawatt laundering issue is to institute the West-Wide Investigation. It is unclear how the West-Wide Investigation could possibly ameliorate the destructive impact of megawatt laundering on California markets. The West-Wide Investigation expressly excludes sales made through the California ISO markets. Without integrating California into the West-Wide Investigation, any mitigation proposed for either California or the WSCC generally is unlikely to be effective.

The circumscribed scope of the West-Wide Investigation compromises the Commission's duty to ensure just and reasonable rates given that the California mitigation scheme only applies to the California ISO real-time market during a "stage" emergency and only to generators in California or sellers with a participating generator agreement. Thus, an incentive and opportunity exists for California resources to circumvent mitigated prices by forward selling power to an affiliate or third-party marketer at a cost above the expected mitigated real-time market price. The marketer can then forward export the power rights to an out-of-state entity that will resell the unmitigated high priced power in real-time to California. Under the April 26 Mitigation Order, the import schedule that provides the final transaction in the chain of transactions is not adequately monitored or mitigated.¹² The West-Wide Investigation does nothing to deter such market manipulation.

C. The Commission's Treatment of Air Emission Costs Will Result In Unjust and Unreasonable Costs In California And Should Not Be Extended To The West Generally.

The Commission suggests that changes proposed in the West-Wide Investigation shall, to the extent possible, mirror the mitigation measures adopted for California markets. The Board supports uniformity. A homogeneous set of market rules covering the entire western region properly acknowledges the integrated nature of the western electricity markets as well as serves to minimize incentives for market manipulation. However, any price mitigation measure implemented for either California or the WSCC generally must be effective to ensure just and reasonable rates. As will be discussed in

¹² Preliminarily, the Board notes that the April 26 Mitigation Order may, in large part, be ineffective to mitigate megawatt laundering because it allows marketers to cost-justify high real-time offer prices on the basis of high prices for forward power purchases.

greater detail by the Board in its petition for rehearing of the April 26 Mitigation Order, aspects of the Commission's solution for California are insufficient to provide the relief to which California is entitled and may, in fact, create perverse incentives that contribute to further market dysfunction.

For purposes of commenting on the West-Wide Investigation, the Board notes that the emissions cost component of the proxy price methodology suffers from several defects and should not be applied in California or any of the western states. The Commission's proxy price methodology calculates purported marginal costs by reference to heat rates for each producers' generating units in conjunction with a proxy for gas costs, emission costs, and a \$2.00 adder for operation and maintenance expenses. The emission cost component is to be calculated using emission costs from Cantor Fitzgerald Environmental Brokerage Services and the emission rate for the unit.

To begin, reference to the emission credit index conflicts with the regulatory scheme for air emissions in California, let alone the entire western region. Only generating facilities within the South Coast Air Quality Management District ("SC Air District") in California were required to purchase nitrogen oxide (NO_x) air emission credits. Thus, any routine cost consideration involving air emission credits could apply only to generators located within the SC Air District. Even as to these facilities, however, the air emission credit program will likely be superseded. Under a proposal to be considered on May 11, 2001, generating plants will be allocated a certain number of emission credits without cost and are subject to an administrative mitigation fee of \$7.50/lb when exceeding permitted emission levels.

Similarly, the Cantor index is irrelevant to generator cost structure in each area of the WSCC which does not require the purchase of emission credits. Thus, use of the Cantor index will inevitably lead to over-compensation for generators.

Because of the divergent state law emission standards and other environmental restrictions throughout the WSCC, there is no reasonably accurate method to approximate emission costs in a way that will result in just and reasonable prices. Such locally specific environmental costs should more appropriately be considered on a seller specific basis as component of its bid specific cost justification. This will serve the dual function of permitting generators to recover air emission costs, while preventing artificially-inflated wholesale power prices.

Moreover, the Commission's proposal creates a pernicious incentive for generators to delay installation of air emission controls on the most inefficient facilities. This incentive will be the greatest for those facilities owned and controlled by entities with a generation portfolio that will all benefit from inflated emission costs in the proxy price.

D. The West-Wide Investigation Should Include Natural Gas Markets.

The Commission's West-Wide Investigation should be broadened to include the monitoring and mitigation of natural gas commodity and transportation markets. Electricity marketers also market natural gas. As such, electricity market power can be leveraged into natural gas market power that, in turn, increases electricity prices. A WSCC investigation provides the necessary and sufficient scope to properly investigate the western natural gas commodity and transportation markets that are the most significant strategic inputs for the electricity product.

IV. CONCLUSION

For the reasons set forth above, the Board respectfully requests that the Commission grant this motion to intervene.

Further, the Board requests that the Commission revise the scope of the West-Wide Investigation to encompass all transactions in all hours, or, alternatively, to suspend market based rate authority throughout the WSCC, including California, until such time as the Commission can affirmatively find that the markets are sufficiently competitive to produce just and reasonable rates.

Dated: May 7, 2001

Respectfully submitted,

/s/

Grant A. Rosenblum
Staff Counsel
California Electricity Oversight Board

CERTIFICATE OF SERVICE

I hereby certify that I have caused the foregoing document to be served upon each person designated on the official service list compiled by the Secretary for this proceeding on or before April 30, 2001, pursuant to Rule 2010(a) of the Commission's Rules of Practice and Procedure.

Dated at Sacramento, California, this 7th day of May, 2001.

/s/

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